Crypto comes to town - how European policymakers and regulators are reacting

After a tumultuous few days on the markets, the political and media spotlight is one again on the nascent crypto industry. As the EU enters the final stages of negotiating its landmark legislation on stablecoins (MiCA) the crypto industry is taking its first, tentative steps into explaining to European policymakers and regulators how their firms and products actually work. And the reactions from the public sector are mixed.

In this short article, I will explain a little more about the industry as I see it, initial responses by European policymakers to recent, increased industry engagement and offer some tips regarding where more attention is needed to secure a constructive dialogue.

EU first mover - advantage or disadvantage?: With the MiCA proposal launched in 2020, the EU became the first major financial regulatory jurisdiction to propose a legislative framework for stablecoins. Whilst EU politicians hope that acting first will see others follow their lead, taking a legislative approach towards regulating an innovative and fast-evolving financial technology runs the risk of the regime being outdated before it is even concluded. The U.K., USA and others are watching the EU's experiment and will seek to take a more incremental future-proof, approach.

Crypto, blockchain and DeFi - far from monolithic definitions or activities: Most media and political interest in crypto focuses on crypto exchanges and currencies as an investment product or speculative asset/trading instrument (or, as some would say currently, a bubble). But such a narrow perspective glosses over more diverse use cases for crypto, blockchain and decentralised finance in terms of disintermediation of traditional finance, particularly in cross-border payments. Besides payments and remittances, there are many real world use cases where building on the blockchain opens up access to finance for SMEs, support providing finance to displaced people fleeing war in Ukraine, buttress the green deal by creating a market for tokenised carbon credit or even support monetary policy by being a partner for public authorities as they develop central bank digital currencies. The EU is mindful of the importance of definitions and scope as it seeks to finalise MiCA and is also starting to understand the opportunities rather than focussing exclusively on the risks.

Transparency, a core principle policymakers should appreciate: Any financial market or product relies strongly on consumer trust. As well as focussing on consumer protection, regulators and policymakers might be pleasantly surprised by the way transparency is baked-into much of the underlying blockchain technology, which is built using open-source. Clearly policymakers will need to have the ability and skills to read and understand the code (see more on this below) but compared to some of the closed systems which exist in traditional financial markets, this level of transparency should be a boon to regulators and a welcome aspect of the modern technology for politicians.

Strategic Advisory Management
E: info@samadvisory.eu

EU policymakers and the industry open to dialogue: Lots of crypto firms did not exist or had only just established when MiCA was proposed. As such, it has been impossible for the usual, pre-legislative engagement with EU policymakers. To the credit of both industry and policymakers, both sides are making significant efforts to catch up. Individual crypto companies and those representing them are undertaking to explain to policymakers how their businesses operate, debunking some of the myths and misconceptions. Crypto and digital finance is now a regular panel on the FS conference circuit, as attested by City Week 2022 in London last month. Policymakers across the EU institutions have been willing to meet bi-laterally too, learning more, first-hand about how this new part of the financial services ecosystem actually operates. This is welcome, as it offers an opportunity to ensure an appropriately calibrated operating environment for firms whilst providing robust rules for supervisors and politicians.

Supervisors and regulators still to be convinced: But one part of officialdom remains concerned and more focussed on the downside risk. Recent statements by France's Central Bank Governor and an ECB executive board member underscore skepticism around the new technology, which, whilst remaining marginal compared to traditional finance, they see as potentially bringing financial stability risk as the sector grows. The recent market rout following a particular stablecoin losing its USD peg has naturally exacerbate these concerns, as well as concerns from market conduct authorities regarding heavy retail investor losses (in spite of sustained warnings from multiple supervisors in the UK, EU and international standard setters). Greater co-operation and co-ordination internationally would be a positive step.

Whether it's MiCA in Europe, a recent speech by U.K. City Minister or President Biden's Executive Order, it seems likely that this industry and technology is here to stay. As such, it is understandable (and welcomed by many in the industry) that policymakers seek to engage to ensure an appropriate regulatory framework for these young technologies and products which are developing into a competitive and innovative market segment.

The younger generation - the digital natives - see crypto as an 'investment'. Policymakers rightly need to ensure consumer protection frameworks apply to crypto, as they do to other financial products marketed to retail consumers. But they also need to ensure citizens have the necessary resources and skills to enable them to make informed choices. In this respect crypto is no different from any other product or industry. Policymakers should embrace this new mindset. If they do, they have a willing partner on the industry side ready to engage on how best to create the operating environment which allows firms to innovate, provides citizens access to products and services they want and reassures politicians the industry is regulated in a robust but tailored/bespoke manner.

Strategic Advisory Management
E: info@samadvisory.eu